

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

GARTH TOSELLO and CATHERINE
TOSELLO,

Debtors.

Case No. 97-54696-JRG-CA

Chapter 13

**ORDER GRANTING MOTION TO
ASSUME LEASES**

I. INTRODUCTION

This motion is brought by the debtors, Garth and Catherine Tosello, seeking to assume two non-residential leases pertaining to their business premises, a video store called "Winged Dragon Video" and a health food store called "Five Mile House." Walter Hickey and Matt Witkins, owners of the shopping center where the Tosellos conduct business, oppose the motion only as to the assumption of the Five Mile House lease. For the reasons hereafter stated the motion to assume both leases will be granted.

II. FACTUAL BACKGROUND

On July 16, 1991, the debtors, Garth and Catherine Tosello, entered into a commercial lease agreement for Winged Dragon Video located in the Corralitos Station center with landlords Walter Hickey and Matt Witkins. The Tosellos are currently operating the video rental store and the current rent is \$942

1 per month.

2 In 1995, the Tosellos purchased a store called the Five
3 Mile House also located in Corralitos Station from its then
4 owner, Mr. Cummins. Five Mile House is a 1,700 square foot
5 health food grocery store and coffee bar. The current rent for
6 this store is \$1,193 per month.

7 The Tosellos financed the purchase of Five Mile House
8 through a \$105,000 SBA loan. They had an outstanding \$60,000
9 SBA loan in connection with their video rental store, Winged
10 Dragon Video. For payment purposes, Coast Commercial Bank
11 merged the \$105,000 SBA loan with the existing \$60,000 SBA loan
12 into a new loan with one payment. Collateral for both SBA loans
13 is the Tosellos' home and both businesses.

14 On January 5, 1995, before escrow closed on the Five Mile
15 House, the Tosellos entered into a second commercial lease
16 agreement with the owners of Corralitos Station, Walter Hickey
17 and Matt Witkins. (All references hereafter to the lease or
18 lease agreement refer to the Five Mile House lease). The lease
19 agreement was negotiated by Garth Tosello and Walter Hickey.
20 Neither party was represented by counsel. At the time of the
21 negotiations, the Tosellos were aware that their landlords were
22 intending to further develop Corralitos Station and to add a
23 grocery store as an anchor tenant. There was no discussion at
24 this time of which space in the center the future grocery store
25 would occupy or how many square feet the grocery store might
26 encompass.

27 The lease agreement was a somewhat typical typewritten
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1 document to which Tosello and Hickey added three hand written
2 paragraphs dealing in part with the anticipated grocery store.

3 Paragraph 42 states:

4 42. OPTION. Provided Tenant is not in default, tenant
5 shall have the option to extend the term of this lease
6 for two three year periods on the same terms and
7 conditions as this lease. This option to extend must
be exercised by delivery of a written notice to
landlord 90 days prior to the end of lease term.

8 Paragraph 42 was intended to be a standard option to renew
9 the lease for two additional three-year terms.¹ The original
10 lease term expired December 31, 1997. The Tosellos have
11 exercised the option to extend the Five Mile House lease for an
12 additional three years.

13 Paragraph 43 states:

14 43. Tenant shall have the right of first refusal to lease a
15 grocery space upon completion of the new center to be
16 constructed in the future on this site known as
17 Corralitos Station. Tenant shall provide written
notice to landlord of his intent to lease said space
within 60 days of landlord notice to tenant that space
will be available for lease.

18 The parties intended that this paragraph be a right of
19 first refusal in regards to the space designated for the future
20 grocery store in the redeveloped center. The lease did not
21 provide however, and the parties did not discuss, any details
22 regarding what performance was required by either party if the
23 option was exercised. The lease simply states that in order for
24 the tenant to exercise this right, the tenant must provide
25 written notice to the landlord within 60 days of landlord's
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27 ¹ In conjunction this addition, with the parties deleted paragraph 40, on
28 the mistaken belief that it was intended to negate any option to renew.

1 notice to tenant that the space will be available for lease.

2 The Tosellos were concerned about a competing grocery
3 store moving into the new space in the same center. They stated
4 their intentions to lease the new space on numerous occasions
5 and the Tosellos purported to exercise their right of first
6 refusal through a letter to the landlords dated April 19, 1996.
7 Despite their statements and actions, the Tosellos argue that
8 the lease plainly states that their notice of intent does not
9 need to be given until after the landlords give notice to the
10 Tosellos that "the space will be available for lease." The
11 Tosellos state that this event has not yet occurred because the
12 new space has not yet been built.

13 The landlords, on the other hand, contend that the Tosellos
14 are required to cooperate with them in order for the new space
15 to be built and are failing to do so. On many occasions, the
16 landlords have requested that the Tosellos provide plans
17 regarding their proposed interior improvements for the grocery
18 space. The landlords have also requested that the Tosellos
19 provide financial information regarding their ability to operate
20 the grocery store to the bank which is providing the landlord's
21 construction financing. The landlords contend that the Tosellos
22 are preventing construction from going forward by their refusal
23 to provide such information.

24 The Tosellos respond that the landlords have not provided
25 them with enough information on which to base a plan for the
26 interior improvements. The evidence shows some inconsistencies
27 on the part of the landlords as to exactly where the future
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1 grocery store would be located and its size.

2 Paragraph 44 states:

3 44. Upon completion of the new commercial development, this
4 lease shall not terminate but shall be merged into a
5 new lease consistent with the leases in the new
6 development. Under the terms of said new lease, the
7 basic rent shall be no more than \$1.10 per square foot
8 (using the figure set forth in paragraph 1 hereof) with
9 triple net provisions (tenant paying as additional rent
all operating expenses of the new commercial property,
including, but not limited to taxes, insurance,
maintenance, repairs, legal & accounting, etc.). The
new lease basic rent shall also be subject to the same
cost of living adjustment described in the lease
agreement executed hereof.

10 The parties disagree whether the rent limitation of \$1.10
11 per square foot relates to the Five Mile House or to the new
12 grocery space. The landlords argue that Garth Tosello was
13 concerned that his rent on the Five Mile House would escalate
14 while the shopping center was being developed so the parties
15 agreed to limit the Five Mile House rent. The Tosellos contend
16 that the rent limitation was intended to be for the new space.

17 The parties also disagree on the meaning of the language
18 "this lease shall not terminate but shall be merged into a new
19 lease consistent with the leases in the new development." The
20 language could be interpreted to mean that the Five Mile House
21 lease was to be re-written on a new form consistent with the
22 other leases in the new center. It could also mean that the
23 lease for the grocery space and the lease for the Five Mile
24 House were to be merged into one document. It is not clear at
25 this time whether the Tosellos intend to keep the Five Mile
26 House as a separate business when the new grocery space is
27 completed.
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1 **III. DISCUSSION**

2 This is a motion to assume two non-residential leases.
3 Pursuant to 11 U.S.C. § 365(a) the debtors may assume the leases
4 subject to court approval. If there has been a default on a
5 lease, under § 365(b), the debtors may not assume the lease
6 unless they cure the default, compensate for any actual
7 pecuniary loss resulting from the default, and provide adequate
8 assurance of future performance under the lease.²

9 The landlords oppose the motion to assume the Five Mile
10 House lease, or at least the right of first refusal provision of
11 the lease, on the basis that the debtors have defaulted on the
12 lease and have not and cannot provide adequate assurance of
13 future performance with regard to the new grocery space.³ In
14 order to determine whether the debtors have defaulted on the
15 lease, the court must first interpret the provisions of the
16 lease relating to the new grocery space. The following issues
17 must be addressed:

18 _____
19 ² 11 U.S.C. § 365 provides in pertinent part:

20 (a) Except as provided in sections 765 and 766 of this title and in
21 subsections (b), (c), and (d) of this section, the trustee, subject to the
22 court's approval, may assume or reject any executory contract or unexpired
23 lease of the debtor.

24 (b)(1) If there has been a default in an executory contract or unexpired lease
25 of the debtor, the trustee may not assume such contract or lease unless, at
26 the time of assumption of such contract or lease, the trustee--

27 (A) cures, or provides adequate assurance that the trustee will promptly
28 cure, such default;

 (B) compensates, or provides adequate assurance that the trustee will
promptly compensate, a party other than the debtor to such contract or
lease, for any actual pecuniary loss to such party resulting from such
default; and

 (C) provides adequate assurance of future performance under such
contract or lease.

³ Because there is no opposition to assumption of the Winged Dragon Video
lease, the court's discussion will focus solely on the Five Miles House lease.

1 1. Whether the right of first refusal provision of the
2 lease (paragraph 43) is enforceable.

3 2. What procedures are required to exercise and perform
4 under the right of first refusal.

5 3. Whether the base rent of the grocery space is limited
6 to \$1.10.

7 After the above issues are determined, the court can then
8 determine the ultimate issue of whether the Tosellos can assume
9 the lease.

10 California law states that, "[a] contract must be
11 interpreted as to give effect to the mutual intention of the
12 parties as it existed at the time of contracting, so far as the
13 same is ascertainable and lawful." Cal.Civ.Code § 1636
14 (entitled "Mutual effect to be given"). With this governing
15 principle in mind the court will examine the evidence to
16 determine the mutual intention of the Tosellos and their
17 landlords at the time the contract was made.

18 **A. The Right Of First Refusal Is An Enforceable Contract**
19 **Provision.**

20 The right of first refusal contained in paragraph 43 states
21 in part: "[t]enant shall have the right of first refusal to
22 lease a grocery space upon completion of the new center to be
23 constructed in the future on this site known as Corralitos
24 Station." In interpreting a contract, paramount consideration
25 is given to the intention of the parties. Intent may be
26 ascertained from the words used and by taking into account the
27 entire contract and circumstances under which it was made. Moss

1 Development Co. v. Geary, 41 Cal.App.3d 1 (1974). In this case,
2 the Tosellos expressed concern about direct competition in
3 Corralitos Station. Such a concern seems obvious in any smaller
4 shopping center. The court does not believe that someone would
5 invest \$150,000 in a business only to have their landlord
6 install a competitor across the parking lot. Thus it appears
7 that the intent of the parties was to protect the Tosellos'
8 investment against potential competition by giving the Tosellos
9 a right of first refusal to lease the new grocery space.

10 In addition, California follows the rule of practical
11 construction. The rule provides that when a contract is
12 ambiguous, great weight is given to the acts and conduct of the
13 parties with knowledge of the contract terms, before any dispute
14 arises. Work v. Associated Almond Growers, 102 Cal.App. 232,
15 235 (1929).

16 In this case, the conduct of the parties is consistent with
17 the existence of the right of first refusal. Subsequent
18 communication attempts were made by both parties regarding the
19 development of the grocery space. The landlords, on several
20 occasions, requested financial and interior design information
21 from the Tosellos. The Tosellos attempted to confer with the
22 landlords concerning the available square footage of the grocery
23 space. The parties' subsequent acts and conduct signify that
24 their intentions were, at the time of contracting, to provide
25 the Tosellos the right of first refusal in regards to the
26 contemplated grocery space. Moreover, Walter Hickey drafted
27 paragraph 43 to specifically address the Tosellos' concern. The
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1 court finds the intent of the parties to be quite clear:
2 paragraph 43 was included to allow the Tosellos the right of
3 first refusal to operate the new grocery space.

4 The landlords have requested that the court sever paragraph
5 43 from the lease because of its alleged ambiguity. This cannot
6 be done. "The whole of a contract is to be taken together, so
7 as to give effect to every part, if reasonably practicable, each
8 clause helping to interpret the other." Cal.Civ.Code § 1641
9 (entitled "Whole contract, effect to be given"). This lease
10 agreement must be viewed in its entirety. The court also notes
11 that any ambiguities in a contract are to be construed against
12 the party who wrote the contract. Cal.Civ.Code § 1654 (entitled
13 "Uncertainty; interpretation against person causing"). Walter
14 Hickey drafted paragraph 43, consequently, it should be
15 construed against the landlords. Thus, paragraph 43 is an
16 enforceable contract provision because the clear intent of the
17 parties was to provide the Tosellos with a right of first
18 refusal.

19 **B. The Procedures to Exercise and Perform Under the Right**
20 **of First Refusal Can Be Derived From the Language of**
the Contract.

21 While the intent of the parties regarding the right of
22 first refusal is clear, there is some ambiguity regarding the
23 procedures to be followed once the right is exercised. Words of
24 a contract are to be understood in their ordinary and popular
25 sense, rather than according to their strict legal meaning.
26 Cal.Civ.Code § 1644 (entitled "Sense of words"). Based solely
27 on the ordinary and popular meaning of the words contained in
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1 paragraph 43, the procedures to exercise and perform under the
2 right of first refusal can be derived from the language.

3 Paragraph 43 states, "[t]enant shall provide written notice
4 to landlord of his intent to lease said space within 60 days of
5 landlord notice to tenant that space will be available for
6 lease." The court's interpretation of the ordinary meaning of
7 the words used is that the landlords must initiate the process
8 by giving a notice to the Tosellos. The notice must contain a
9 reasonably specific date on which the grocery space will be
10 available for occupancy. In addition, the notice must contain a
11 reasonably accurate estimate of the square footage being made
12 available for the grocery store and its proposed location.
13 Without this information the Tosellos would not be in a position
14 to make an informed decision.

15 In this case, the landlords did not give a notice
16 containing a reasonably specific date on which the space will be
17 available for occupancy. The notice also did not contain a
18 reasonably accurate estimate of the square footage being made
19 available for the grocery store and its proposed location. Only
20 upon receiving the landlords' notice containing those elements
21 are the Tosellos required to exercise the right of first refusal
22 within the 60-day period. Because the Tosellos have not
23 received the proper notice, the landlords' contention that the
24 Tosellos have defaulted on performance relating to the right of
25 first refusal is not valid.

26 The first default on performance that the landlords allege
27 is that the Tosellos have not provided interior design and
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1 specifications for the new grocery space. In interpreting a
2 contract the court is to imply all things in law or usage that
3 are considered incidental to a contract or are necessary to
4 carry it into effect. Cal.Civ.Code § 1656 (entitled "Implied
5 incidents"). Courts will insert an implied provision when it is
6 necessary to carry out the intention of the parties. Foley v.
7 Euless, 214 Cal. 506 (1931), Loyalton Electric Light Co. v.
8 California Pine Box & Lumber Co., 22 Cal.App. 75 (1913).

9 In this case, the interior design specifications for the
10 grocery store are necessary if the space is going to be built
11 out in a manner that satisfies Tosellos' needs. As a result,
12 the intended purpose of the contract can only be carried out if
13 the Tosellos provide their landlords with a proposed design of
14 the grocery space at the time during the development process
15 when it is needed. The Tosellos are therefore required to
16 provide the landlords with the interior design and
17 specifications of the grocery space within a reasonable time of
18 being asked to do so after exercising the right of first
19 refusal. Because the Tosellos have not received the proper
20 notice, the Tosellos have not defaulted at this time by failing
21 to provide interior design and specifications of the grocery
22 space to the landlords.

23 The second default on performance that the landlords allege
24 is that the Tosellos have not provided financial information to
25 the bank as requested by the landlords. While design
26 information appears essential for the purpose of the contract to
27 be accomplished, the same can not be said for financial
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1 information relating to construction financing. The landlord
2 may, or may not, need such information. Nevertheless, a
3 contract must be given an interpretation that will make it
4 operative, reasonable and capable of being carried into effect,
5 if that can be done without violating the intention of the
6 parties. Cal.Civ.Code § 1643 (entitled "Interpretation in favor
7 of contract"). Asking a tenant for financial information in
8 connection with construction financing does not place an
9 unreasonable burden on the tenant. Such assistance may turn out
10 to be absolutely necessary if the shopping center is to be
11 developed further which was the intention of the parties at the
12 time the contract was made. Therefore, the Tosellos must
13 provide financial information within a reasonable time after
14 being requested to do so by their landlords. However, because
15 the Tosellos have not received the proper notice, the Tosellos
16 have not defaulted at this time by failing to provide financial
17 information to the landlords

18 **C. The \$1.10 Base Rent Applies To The New Grocery**
19 **Space.**

20 The parties disagree as to whether the \$1.10 per square
21 foot rent cap applies to the grocery space to be developed.
22 Because the Tosellos cannot make an informed decision of whether
23 to exercise the right of first refusal without knowing the
24 potential amount of the rent, the court must interpret the rent
25 provision. The rent provision located in paragraph 44 states:
26 "[u]pon completion of the new commercial development, this lease
27 shall not terminate but shall be merged into a new lease
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1 consistent with the leases in the new development. Under the
2 terms of said new lease, the basic rent shall be no more than
3 \$1.10 per square foot...."

4 The language of a contract is to govern its interpretation
5 if language is clear and explicit. Cal.Civ.Code § 1638
6 (entitled "Ascertainment of intention; language"); Toms v.
7 Hellman, 115 Cal.App. 74 (1931). With respect to the Five Mile
8 House, the rental provisions in the current lease are clear.
9 Paragraph 3 provides for a base rent and paragraph 4 provides
10 for annual cost of living adjustments. Paragraph 42 provides
11 for two three-year options to renew the lease "on the same terms
12 and conditions as this lease." This phrase can only be
13 interpreted to mean that the annual cost of living adjustments
14 will continue. The \$1.10 figure does not fit into the rental
15 structure of the Five Mile House and, in fact, might directly
16 contradict the rental figure arrived at through paragraphs 3 and
17 4.

18 As previously stated, "[a] contract must be interpreted as
19 to give affect to the mutual intention of the parties as it
20 existed at the time of contracting, so far as the same is
21 ascertainable and lawful." Cal.Civ.Code § 1636. According to
22 Garth Tosello's testimony, his understanding of the lease
23 agreement was that he would have the option to retain the Five
24 Mile House and also operate the grocery store when the space was
25 developed. Thus, the court finds that the \$1.10 figure is the
26 base rent for the new grocery space.

27 **D. The Tosellos May Assume the Leases Under Section**
28 **365(a).**

1 The Tosellos seek court approval of assumption of the two
2 non-residential leases under § 365(a). Section 365(a) provides
3 that "[e]xcept as provided in sections 765 and 766 of this title
4 and in subsections (b), (c), and (d) of this section, the
5 trustee, subject to the court's approval, may assume or reject
6 any executory contract or unexpired lease of the debtor." The
7 landlords object to the assumption of the Five Mile House lease
8 on the basis that the Tosellos have defaulted on the lease.
9 Furthermore, the landlords argue that because the Tosellos have
10 defaulted, § 365(b) requires, among other things, that the
11 Tosellos provide adequate assurance of future performance. See
12 11 U.S.C. § 365(b). Because the court has concluded that the
13 Tosellos have not defaulted on the lease, § 365(b) is
14 inapplicable and the Tosellos are not required to provide such
15 assurances.⁴ The court finds that pursuant to § 365(a) the
16 Tosellos may assume both of the leases.

17 **VI. CONCLUSION**

18 For the foregoing reasons, the debtors' motion to assume
19 the two non-residential real property leases is granted.
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25 ⁴ However, if the Tosellos were required to provide adequate assurance of
26 future performance, the court finds that the Tosellos have demonstrated such
27 assurances. George Tosello is the father of the Garth Tosello and testified
28 that he would financially assist his son. He offers financial assistance
between \$110,000 and \$120,000. This assures that the new grocery store can be
completed and stocked, and that the landlords will begin receiving their rent.
This is sufficient to satisfy § 365(b)(1)(C).